



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201241011**  
Release Date: 10/12/2012  
Date: 5/21/2012

Contact Person:  
Identification Number:  
Contact Number:  
FAX Number:  
Employer Identification Number:

**LEGEND:**

C =  
D =  
M =  
N date =

**UIL:**

501.03-00  
501.03-05  
501.32-00  
501.33-00

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

**Issues**

1. Do your activities constitute substantial non-exempt purposes which cause you to fail the operational test and disqualifies you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
2. Do the payments for the personal expenses of your founder constitute inurement, disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

**Facts**

You were incorporated in the State of M on N date.

You were previously granted exemption under Section 501(c)(3) of the Code. Your exemption was revoked due to non-filing of Form 990 for three tax years. Accordingly, you submitted this new Form 1023, Application for Recognition of Exemption.

Your Articles of Incorporation state that your purposes include:

Church, Telemarketing, Social Services, Shelter for battered women. Drug, Alcohol rehab club, (12step program), Halfway housing for men and women. Rehab Program.

Your officers are four persons with the same last name. C is listed as the Program Director. The other three listed officers have been identified as uncles of C. None of these three officers spend hours working for you at this time. They are business men who you identified as your advisors.

You reported estimated compensation to be paid to C as your Program Director and the other officers. But, to date, no one has received any compensation as an officer or employee. You explained that the proposed salaries for C and the other officers are "dream" compensation in the event your operations expand to the point where enough revenue is generated to permit these payments. To date, you also stated that you have not received adequate funding to conduct the activities enumerated in your Articles of Incorporation.

C is your sole contributor. C's contributions are primarily payments for her services as a personal assistant to clients through M's home service programs. M deposits C's earnings into your checking account.

Review of your bank statements found you issued checks to pay loans and repair expenses associated with C's vehicle. You made disbursements to pay C's student loans and help C's daughter who is in college. You pay for 2 phone lines in C's home and a phone line in another city. About \$140 is paid on a rent-to-own contract for a small building which serves as your office. According to bank statements, small purchases were made at gas stations, a liquor store, a tobacco outlet, car rental agencies, beauty supply outlets, and a restaurant.

There were also several ATM withdrawals and many checks written throughout the years. Numerous overdraft fees were incurred and paid by you.

When asked to explain the monthly payments of almost \$200 made to the U.S. Department of Education. You stated:

I was trying to pay on a student loan. The people who I was paying was [sic] not telling me the truth about the program. I desire to go back to school to finish my degree in Business. So I was paying them, in order to go back to school, but they lied to me about their program. My organization will help people go to an [sic] higher learning institution if they choose to go back to college.

When asked to provide a list of your activities, you reported that C has provided assistance to 3 to 4 teens with room and board and serves as godmother for 7 children. In addition, C provides Christmas and birthday gifts to less fortunate children, baby supplies for unwed mothers, food for employees once a year, clothes for the women's shelter, tax preparation assistance, shared with neighbors when they were in need, and assistance and transportation to the elderly, church members and unemployed.

You were instructed to include detailed information concerning each of your activities. You have not provided any of the requested details. You did not describe how the public is made aware of your services. You have not explained the methods used to select persons who received assistance. You have not provided any records to substantiate the time required or the dates and costs associated with these activities.

You stated that, "This is a private family organization created by C in order to leave some type of legacy for my kids and grandchildren." In your March 21, 2011 response, you stated, "I (C) am D [you]."

## **Law**

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(a)-1(c) of the regulations provides that the terms "private shareholder or individual" in Section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages

primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals as defined in Section 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit private interests such as "designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

In Rev. Rul. 78-232, 1978-1 C.B. 69 (1978), held that a church is operated for the private purposes of the taxpayer and thus is not operated exclusively for religious or other charitable purposes where an individual who claims to be a minister, organizes a church, deposits checks for salary earned from outside employment in the church's bank account, and uses the funds of the account for lodging, food, clothing, and other living expenses. The court concluded that the taxpayer had retained complete control and enjoyment of the church's money.

Rev. Rul. 81-94, 1981-1 C.B. 330 (1981) determined that a church that was formed by a professional nurse (who is also the "church's" minister, director, and principal officer) and that is used primarily as a vehicle for handling the nurse's personal financial transactions is not exempt from tax under section 501 (c) (3) of the Code.

All salary payments received from the nurse's third-party employer were deposited in a bank account maintained in the name of the corporation. In return, all of the nurse's existing liabilities, such as a home mortgage and all outstanding credit card balances, were assumed by the corporation. The nurse was also provided with a full living allowance sufficient to maintain or improve the nurse's previous standard of living. The corporation permitted the nurse to use the house and automobile for personal purposes.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in substantial private benefit to its founders.

In reaching this conclusion, the court found that the organization could not operate without its original founders. Therefore, the officers were free to set policy for their own benefit without objection from the board.

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1979), aff'd without op., 631 F.2d736 (7<sup>th</sup> Cir. 1980); cert. den. 450 U.S. 981 (1981), the Tax Court held that although separate requirements, the "private inurement" test and the "operated exclusively for exempt purposes" test often overlap substantially. The court concluded that organization had failed the "inurement of net earnings" test because the organization was unable to definitively document its financial dealings due to inadequate records.

The court also concluded that the organizations activities were more personal than church oriented because the founder selected the individuals who allegedly received the money from the checks written on its bank account to cash. The founder testified that the individuals selected were people whom he personally knew to be in need of funds. In its decision, the court pointed out that the grants were not made in an objective and nondiscriminatory manner based on established criteria. The court stated that grants made on a personal basis do not constitute exempt activity.

In Unitary Mission Church v. Commissioner, 74 T.C. 507 (1980), it was held that the prohibition against inurement or private benefit is absolute, the amount or extent not being determinative.

The court found that the petitioner's financial decisions were controlled by X, one of petitioner's ministers, and his wife. X received widely fluctuating "parsonage allowances" over a 3-year period as compensation for leading services and for being available for pastoral counseling. There was no evidence in the administrative record of any differing duties that he performed over these years. There was insufficient evidence in the record regarding some of the travel expenses paid to X and his wife and regarding two loans made to X's secular employer. Parsonage allowances of fluctuating amounts were paid in some years to petitioner's other two ministers; yet, there was no evidence in the record about any services they performed for petitioner. The Tax Court concluded that petitioner was not entitled to exemption because a part of its net earnings inures to the benefit of private shareholders or individuals.

### **Application of Law**

Section 501(c)(3) of the Code and section 1.501(c)(3) -1(a)(1) of the regulations sets forth two key tests for qualification for exempt status. An organization must be organized and operated exclusively for purposes described in section 501(c)(3) of the Code.

Section 501(c)(3) and the Regulations are clear in denying exemption when an organization operates to benefit the private interests of the persons who are in control of its income and activities. Ample clarification and reinforcement for this concept is provided by Revenue Rulings and court decisions.

Like the organizations described in Revenue Rulings 78-232 and 81-94, C's income is deposited into your bank accounts, she maintains sole control over those bank accounts, and you pay her debts with your funds.

You are similar to KJ's Fund Raisers because you would be unable to continue to operate without your founder, C. As a result, C is in complete control of you and your assets. She is free to spend money to pay personal expenses without objection from the board.

Your operations resemble those of Western Catholic Church in your inability to furnish definitive documentation of your financial dealings. Additional similarities are found in the fact that all your officers are related, and none of your officers or board members, other than C, is actively involved in your governance or operations. Like the founder of Western Catholic, C personally selected the individuals who would be helped by your organization based on her own circle of family, friends and acquaintances.

Finally, like Unitary Mission Church, you have not provided sufficient evidence regarding the charitable purpose of your expenditures. And, there is no detailed information about the charitable services C claims to have performed.

Throughout the application process, you have stated emphatically that you are a private family foundation which was formed to leave some type of legacy for C's children and grandchildren. You made payments for C's truck and student loans. You helped C's daughter and made numerous small purchases. Your debit card and bank account were used regularly by C for personal purposes.

You, like the organizations described in the Revenue Rulings and court cases, have failed the operational test because you have allowed your income to inure to the benefit of your founder, C.

### **Applicant's Position**

In response to our assertion that you failed the operational test, you stated "...maybe perhaps you all have classified me under the wrong exempt status. I have questioned this before." You also said "I have also informed you of that because I only have had a total of 2 clients since 2006 and at this present time I only have 1 client that I only get 20 hrs a week to work for." You went on to say "...with the office expense and keeping me on the road to take care of this government client how do you or anyone else expect for me to start a business and I am not suppose to be the one to start it?" You said this is

“...a very personal organization if I must say so myself.” You continued by stating:

We feel real peoples [sic] personal needs and we enjoy doing that. When you help people it should be a personal thing. I would think or why choose to help at all? I am a very generous person to people who I know without a shadow of a doubt are having serious issues. I believe in what I am doing in the community I live in, and on the job that I work, to keep the organization stay alive [sic] for a lifetime. Its [sic] very hard with no help. I just do the best that I can with what I’m working with. I really believe that I should be classified as a public charity, but you all are the experts at this.

You stated you are in the process of changing the Board of Directors “...due to the fact that 2 of them are deceased at this time and that the others [sic] ones are getting to [sic] old to be involved.” You are “...presently speaking to certain people who I think would be interested in helping.” You are “...a very selective person and I am not in any hurry, or should I be?” You said to “...check your records or do the research...” on the Program Director “...before you assume of me [sic], please.”

### **Service Response to Applicant’s Position**

You did not explain or substantiate your position using citations of legal precedent as we requested. Rather, your response emphasized the fact that C considers the organization her personal business. Although you say you are currently considering other individuals to serve on your board, your past activities and your operations are such that the Service position is unchanged by your response. You do not qualify for exemption under Section 501(c)(3) of the Code.

### **Conclusion**

Based on the above facts and law, we have concluded that you have failed to operate exclusively for purposes described in section 501(c)(3) of the Code because:

1. You serve the private benefit of C and her family, and
2. The payment of the personal expenses of C constitutes prohibited inurement.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more

information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

*Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:*

*"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."*

*The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.*

*Your appeal will be considered incomplete without this statement.*

*If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.*

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.



Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosure: Publication 892  
Notice 437  
Redacted copy of this letter